No. 14796

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

H. S. ANDERSON, JR.,
Appellant,
vs.
UNITED STATES OF AMERICA,
Appellee.

ETHEL H. ANDERSON,
Appellant,
vs.
UNITED STATES OF AMERICA,
Appellee.

ROBERT W. ANDERSON,
Appellant,
vs.
UNITED STATES OF AMERICA,
Appellee.

GLORIA S. ANDERSON,
Appellant,
vs.
UNITED STATES OF AMERICA,
Appellee.

JOHN HARDY ANDERSON,
Appellant,
vs.
UNITED STATES OF AMERICA,
Appellee.

Appeals From the United States District Court for the Southern District of California, Central Division.

REPLY BRIEF FOR APPELLANTS.

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REPLY BRIEF FOR APPELLANTS.

The Partnership Interests Allegedly Purchased by Plaintiffs Did Not Continue to Exist After the Purchase.

On page 22 of its brief the government states the issue as follows:

> "The fundamental controversy concerning the facts presented to the court below is whether, by the ex-

> penditures in question, the taxpayers purchased partnership assets consisting of certain contracts the cost of which was properly recoverable by amortization, as they contended; or whether they purchased a partnership interest, which is a capital asset not subject to depreciation, as the Government claimed. * * *"

The government states that plaintiffs purchased *"a partnership interest."* It argues that the cost of a partnership interest cannot be allocated as the cost basis of assets owned by the partnership and recovered through depreciation or amortization deductions over the useful economic lives of such assets. Rather, the cost must remain as the cost of the intangible partnership interest; or as the government asserts (p. 19):

> "* * * The cost of acquiring such interest is not recoverable through deductions from gross income but must await the determination of gain or loss *upon ultimate disposition of the interest.* * * *" (Emphasis added.)

And the government's brief ends (p. 33) with the suggestion that gain or loss was computable at December 31, 1943, upon the "* * * *ultimate disposition of their investment in the two partnership interests purchased from the estate* * * *." (Emphasis added.)

This argument demonstrates the fallacy of the lower court's decision in the present case.

The partnerships that were dissolved at December 31, 1943, were the two *new* limited partnerships which were created by the five plaintiffs on December 23, 1942 [see the Findings at R. 86]. These partnerships were stipulated to be *new* partnerships [R. 55-56]; they were found

by the lower court to be *new* partnerships [R. 85-86]; and they were created one year after the decedent's death on December 27, 1941. Neither the decedent nor his estate ever owned any interest in such *new* partnerships.

It is obvious that the five plaintiffs could not and did not purchase an interest in the *new* partnerships from the decedent or his estate.

The only partnerships in which the decedent or his estate ever had any interest were the *old* partnerships which admittedly, under California law, were *dissolved* by the death of the decedent.

It is true that *dissolution* does not automatically *terminate* a partnership under California law. The partnership existence continues by statute "* * * until the winding up of partnership affairs is completed." (Cal. Corp. Code, Sec. 15030.)

But the crucial point is that at some stage in the proceedings the separate existence of the old partnership did cease.

The *new* partnership created by the five plaintiffs was a separate partnership completely distinct from the *old* partnership.

The sum paid to the decedent's estate was not the purchase price of an interest in the *new* partnerships. It was the purchase price of the decedent's interest in the *old* partnerships.

The crux of this case can best be illustrated by assuming that the surviving partner *alone* had purchased the decedent's interest in the old partnership. It will be observed that it was the *sole* surviving partner in the old California partnership who agreed, *as such surviving*

partner, to pay $75,000 into the decedent's estate. Let us assume he had done so and had continued the business as a sole proprietorship. It would have been clear in that event that the partnership interest purchased from decedent's estate would have ceased to exist, and there would have been no alternative but to allocate the purchase price as the basis of the business assets acquired.

The underlying principle, we respectfully submit, is not changed by the circumstance that the surviving partner, instead of making the purchase alone, interested four others in joining with him, and together they contributed the $75,000 *and formed a new limited partnership* as the vehicle with which to continue the business.

The fact remains that the partnership interest purchased from the decedent's estate has ceased to exist, as effectively in the latter case as in the former, and the cost must be allocated as basis of the assets.

With respect to the *new* partnership, the cost is governed by the long-standing regulations of the Internal Revenue Service (Regs. 118, Sec. 39.113(a)(13)-1):

> "The basis of property contributed in kind by a partner to partnership capital after February 28, 1913, is the cost or other basis thereof to the contributing partner. Annual allowances to the partnership for depletion and depreciation are to be computed on such basis. * * *"

We respectfully submit that what happened *as a matter of fact and as a matter of law* was as follows: the decedent's interest in the dissolved partnership was purchased either by the five plaintiffs individually for $75,000 or by a new limited partnership which they had just created by contributing cash capital of $75,000, which in

turn was paid into the estate. The old partnership thereupon was terminated and ceased to exist, and its assets were distributed in kind to the five plaintiffs or to the new limited partnership. In either event, the following rule of the regulations applies (Regs. 118, Sec. 39.113 (a)(13)-2):

> "* * * If the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received in liquidation. The basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property."

Consequently, the property theretofore owned by the old partnership acquired a basis equal to the cost of $75,000.

The parties to this action stipulated [R. 55] that the contracts and purchase orders owned by the old partnerships at the decedent's death had useful lives of two years, as determined by the Internal Revenue Agent.

With all due respect we submit that the government is here attempting to repudiate the action of its Internal Revenue Agent, in carrying out his official duties, as well as to repudiate the stipulation of facts entered into between the parties. The purpose of the stipulation that the contracts had a life of two years was to establish the period over which the value to be ascribed to such contracts should be amortized. We think the government is precluded from now contending, in the face of such stipulation, that the contracts did not represent binding commitments of any substantial duration (p. 18) or of any real substance (pp. 27, 29). We respectfully submit

that the stipulated facts must govern the decision of this case.

And we respectfully direct the Court's attention to pages 21-24 of our opening brief, quoting the uncontradicted evidence with respect to the value of the contracts and purchase orders which had a stipulated two-year life.

In reply to the suggestion throughout the government's brief that the purchase price was for good will or going concern value, we refer the Court to the statement in the lower court's Memorandum of Decision [R. 64] that the record shows that good will was not purchased, unless it was $4,000.

None of the cases cited by the government on page 31 is applicable here. They held, under varying factual circumstances, that payments to retiring partners or the estates of deceased partners should be capitalized rather than expensed. But they did not consider the question presented here: that the capital expenditure, if the old partnership is dissolved and goes out of existence, should and must be allocated as the cost of the assets owned by the former partnership.

Conclusion.

In summary, we respectfully submit that under California law the old partnership was dissolved by the death of the decedent. Notwithstanding such dissolution the existence of the partnership continued, but solely for the purpose of winding up its affairs. The interest of the decedent was purchased by the plaintiffs and the plaintiffs then proceeded to conduct the business under a new limited partnership. This limited partnership was not the same partnership as the old partnership in which

the decedent had an interest. Under the regulations above quoted the new partnership had a certain basis for its assets, and that basis was the cost basis of the partners. Hence the new partnership was correct in amortizing the cost of those assets over the life of those assets. The asset owned by the new partnership was *not* an interest in the old partnership.

We respectfully submit that the lower court erred and its judgment should be reversed.

Dated at Los Angeles, California this 8th day of February, 1956.

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